RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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October 22, 1980 **LETTER 794**

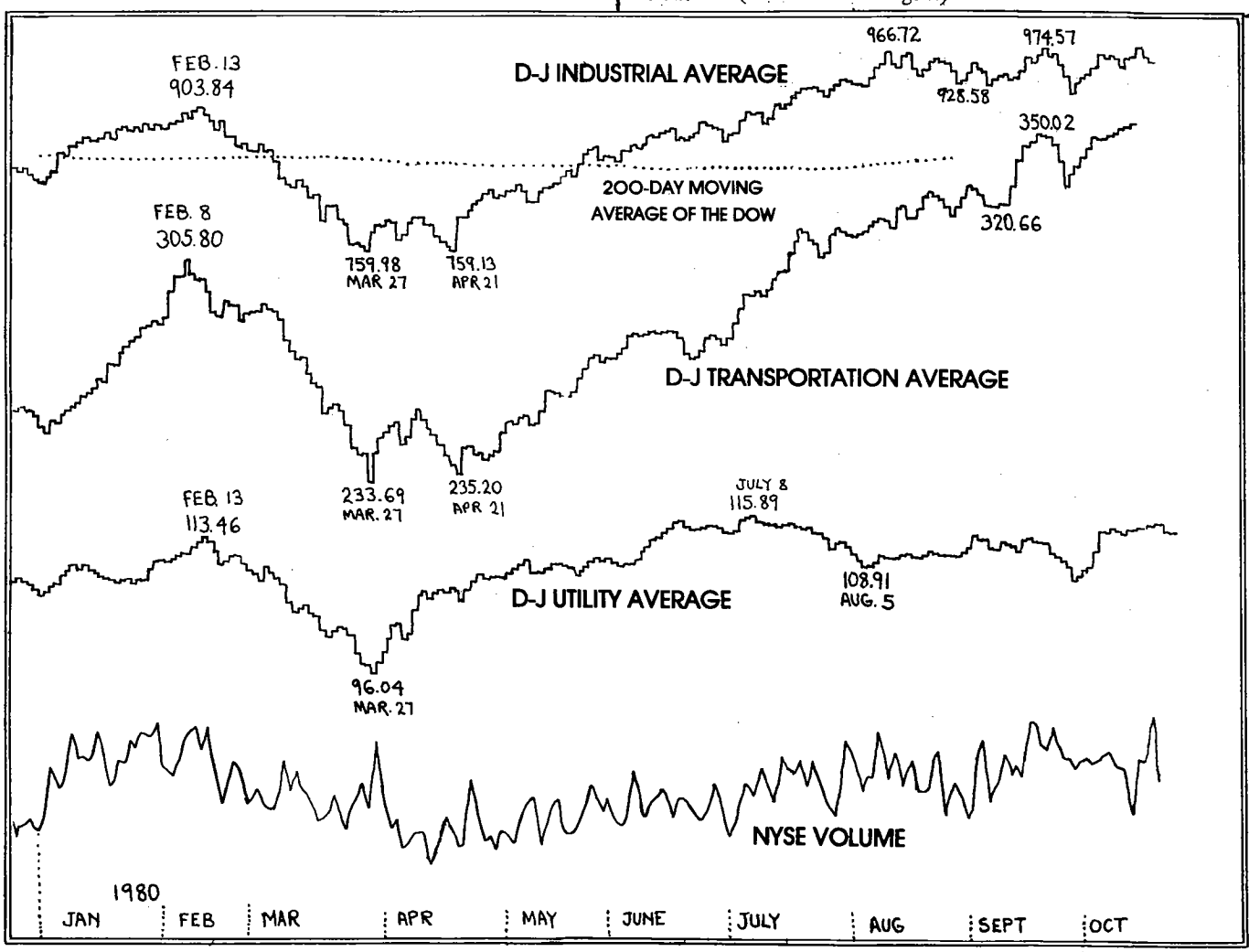
Oct. 10, DJIA 950.68; PTI 1331; A-D Ratio –16.38
Oct. 17, DJIA 946.42; PTI 1342; A-D Ratio –16.40

GOOD NEWS ? Ever since I started this report in 1958, I've held to the theory that God must love the US. The proof is that when this nation needed a good leader, that leader somehow appeared. On the basis of this thesis, I am hopeful that Jimmy Carter is finished, that the American people have seen through this incompetent, power-hungry politician, and that Ronald Reagan will be our next President. Whether Reagan will fit the ticket, whether he will live up to need and expectations, I don't know. But I do know this: Reagan is headed in the right direction. I agree with much of what I've heard from Reagan in both the economic and military spheres. I think Reagan will pick good advisors, and above all, Reagan represents a major departure from most of what Jimmy Carter stands for.

The strongest single instinct in any animal (including the human animal) is the instinct for survival. In order to get anything done, you first must survive. On the basis of the American survival instinct if nothing else, I am betting that Carter will be given his walking papers next month. The American people want to survive, and ultimately they will do what they have to to survive. The first act must be to jettison Carter and his whole fatuous show.

FRONT PAGE COMMENT: It may be a bit early for "New Year Predictions" but I'm going to make one anyway. I'm predicting that interest rates are going to provide the big financial news for 1981. So far, despite all kinds of optimistic forecasts, interest rates continue to hold at high levels. The US Government's need for new money is insatiable, and in this quarter alone the Treasury will have to raise almost $30 billion in new cash. Add the financing for the coming massive military build-up, and you're looking at the financial world's counterpart of "the great white shark." On top of this, business's need for cash remains acute, and much corporate refinancing has been held off awaiting more advantageous money market conditions. Those conditions have not arrived, and this means that instead of being able to float bonds, corporations will be increasingly driven into the short-term money markets.

The need for quick cash has again given us an "inverted" or "negative yield curve" with shortest-term rates above longer-term rates. For instance, the 91-day bills now yield .12 basis points more than the 1-year notes. This is pressure, and it's arriving rather soon in the new "recovery." Therefore, I am predicting that we're going to see fireworks in the money markets during 1981. (continued on Page 2)



To show you how volatility is increasing, consider this: The bank prime rate was changed 15 times in both 1978 and 1979. In contrast, the prime has already changed 28 times in 1980! Final thought: wait until after elections to see what the Fed has in mind. Until then–politics and political pressures will rule.

That's "good news No. 1." Good news No. 2 is technical, based on the pattern of the Standard & Poor's 500 Stock Index (p. 2) and I'll get to that in a minute. But I ask myself, what does the market see? What can Wall Street know that we don't know?

Would a Reagan victory change the course of America? Would Reagan be able to revitalize corporate America? I don't know, but I would hope that he would at least help. Or does the market see some new discovery, perhaps a new source for energy? Or is the market saying that Russia is in economic trouble, that the Red Bear has bitten off more than it can chew and that crop failures and Poland and Cuba and Afghanistan are pushing Russia towards bankruptcy? Then, there is always the chance that Wall Street is simply saying that the worst has now been discounted, and that there's no where for the US to go but–up!

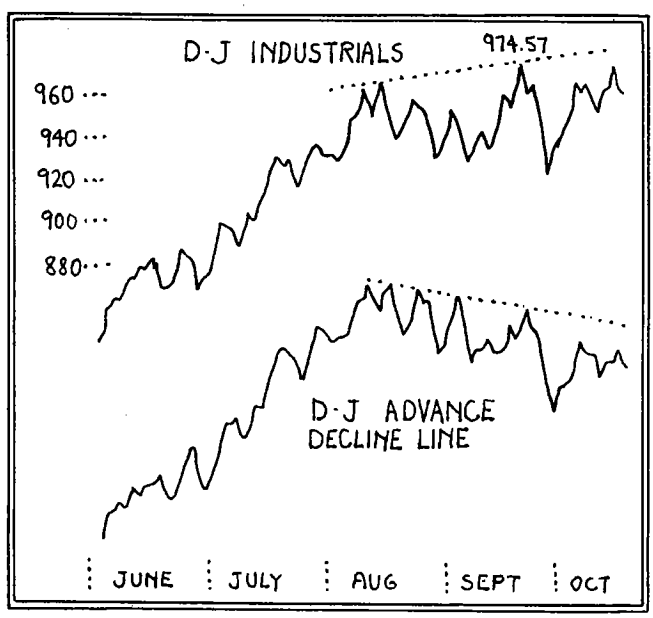
Regardless of all arguments to the contrary, I suggest that we now use the Standard & Poor's 500 chart together with the Primary Trend Index (PTI) to guide us in our market operations.

I am again including this point & figure chart of the Standard & Poor's 500 stock Composite. The Index contains 500 industrial, transport and utility stocks and it is based on the total value of these 500 stocks (the price of each stock is multiplied by the number of shares outstanding).

There's no doubt about the powerful look of this chart. As described in previous Letters, this is a "head-and-shoulders" bottom pattern, with the upside breakout occurring recently at the 120 level. The Index then rose to the 130 box, backed off to 124, then rallied to the high again. This is a powerful performance, and even now this Index could correct back to 124 and still retain its near-term strength (chart courtesy of Chartcraft, Larchmont, NY).

There is no questionning the fact that through most of September and October this market has ignored all the bad news. For instance, in the face of the Iranian-Iraqi war, and in the face of a boost of 1% (to 11%) in the discount rate, the market continued to perform well. Finally, on October 16 we saw the first signs of weakness, and I want to remind subscribers again that the market is still traveling in the bearish segment of the 233-day cycle (see last Letter, page 2). These cycles can be tricky, and in many cases weakness has been held off by a strong market, only to surface with a vengeance near the end of the bearish segment (note: the bearish segment of the current 233-day cycle ends around November 10).

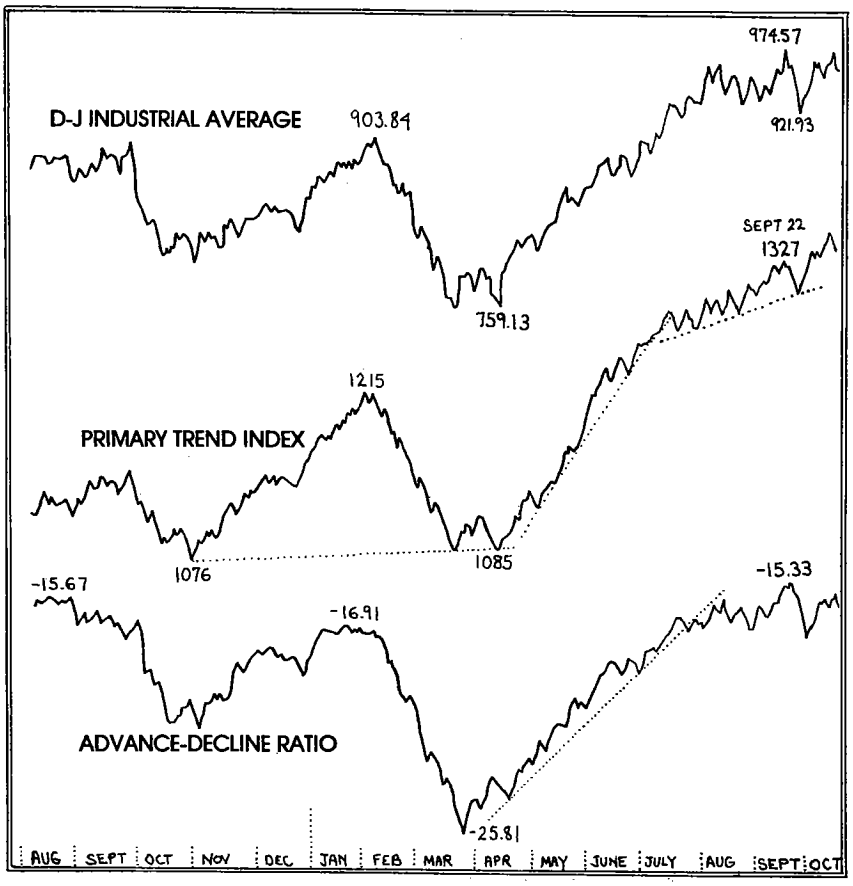
I must admit that I find the market situation particularly fascinating at present. I say this because a few elements of technical weakness are finally beginning to sneak into the picture. In the last Letter I drew attention to the Dow and its own advance-decline line (a line based on the daily plurality of advances or declines in only the 30 Dow Industrials). I include this chart up-dated for this report. As you can see, the picture looks no better. The breadth in the Dow continues to lag, and the divergence between Dow price and breadth is obvious. The situation was dramatized on October 16 when the Dow rallied up 10 points (to a new intra-day high), then plunged to close off over 13 points.



From the Dow Theory standpoint, a non-confirmation has been in effect since September 22. On that day the D-J Industrials closed at 974.57. A violent 5-day retreat followed, but on the new advance the Transports surged to all-time record highs (as did the major non-Dow averages). On October 16, as the Dow plunged, Transports rose to another all-time high of 356.21.

Thus, the non-confirmation between Industrials and Transports remains. If the situation is to be cleared up, the Dow will have to rally and better the September 22 level of 974.57. Failing that, an erratic period may be expected, with the added probability that a top is being formed.

I do not have the latest short interest figures, but they should be out by the time you receive this Letter. If the short interest is little changed or up, it will again be a case of too much money being lined up on the wrong side of the market. As I've said



ever since I started these reports, it's all right if you pass on a move in the market, but it's a disaster if you bet your money against it. The market is always there, and the man who misses or avoids one move can play the next. But to stubbornly wager against the primary trend is the worst of all financial mistakes. Fighting the trend will leave you off-balance, under great stress, and worst of all–poorer but not necessarily wiser.

Cyclical studies, odd lot studies, sentiment studies, short interest studies and even monetary studies are all open to interpretation. And in the end the problem with most of these studies is that despite what they are saying, we know that "the market can do anything."

I must admit, therefore, that the endeavor which gives me most comfort and assurance is the study of my own indicator, the Primary Trend Index (PTI). I trust the PTI because it is based strictly on market ACTION, and this is the reason it cannot be fooled. True, the PTI might give a coincident signal, it might even be a bit late with a signal, but it must tell us the true story during any important market move. For instance, there is no way that the PTI can embark on a major upward leg without producing stock market profits. And there is no way the PTI can sink into a major decline without also manufacturing big losses for shareholders.

Actually, as those who have followed the PTI for a year or so can attest, the PTI has given remarkably good and reliable readings. Since it turned up in April, 1980 (see chart), there has been no whipsaw or false signal. The hard part was BELIEVING what the PTI was saying (the more so this year, since many of the time-tested indicators that I follow gave false signals or omitted signals during the March to October advance).

Study the daily chart (left) of the Dow, the PTI and the A-D ratio. This chart is a regular feature of these reports, and an up-dated version appears in each Letter. Note the extraordinary raise in the PTI, a rise that began at the April 21 low of 1085. The advance progressed along a very steep trendline from April to July. In July the angle of ascent flattened, and I have drawn a new rising trendline that has contained all the PTI action from July to the present.

The current, shallower trendline has been tested on three separate occasions, the latest being at the panic low of September 29 (1300 on the PTI). Since that low the PTI has risen impressively, and on October 15 this indicator registered a record high of 1351.

The latest test for the PTI may now be in progress, assuming the weakness which began on October 16 continues. Since the market story is never told in a day or two, I will repeat again that the PTI must go down on a trend basis before it deserves the "bearish" label. The first step in the bear case would be a PTI breaking of its latest trendline. This has **not** yet occurred.

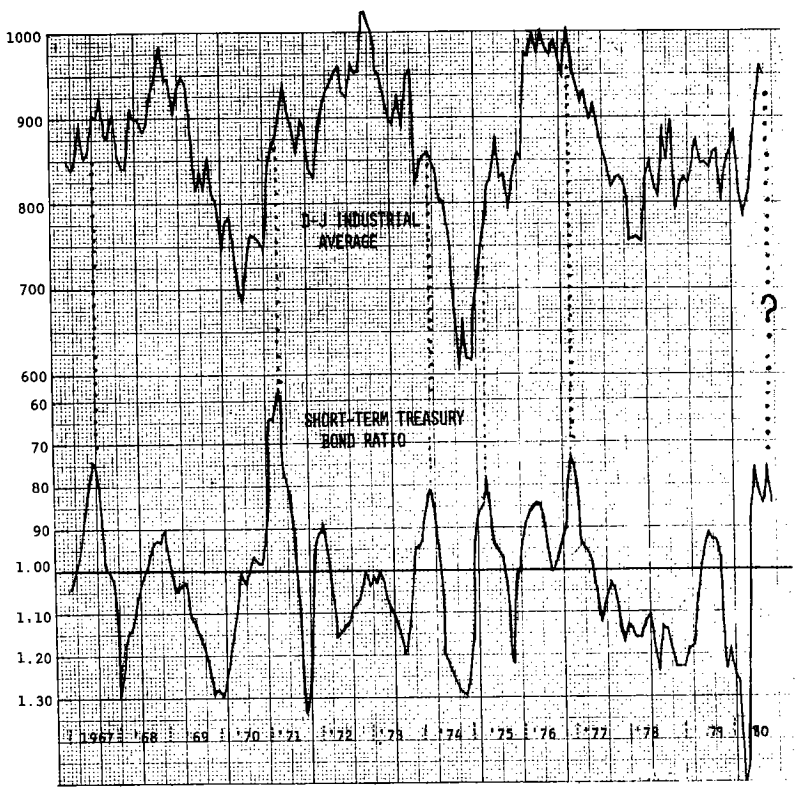
The A-D ratio has been a laggard, failing to confirm the new highs in the major non-Dow averages. As of October 16, the A-D was 3/4 of a point below its September 19 high. Thus price (as measured by the NYSE Index) and the A-D ratio are out-of -wack; a non-confirmation exists here as well.

CONCLUSION: The bearish segment of the 233-day cycle began on August 15 with the Dow at 966. The Dow is below that level now. I suggest that we sit tight until the bearish cycle ends near the middle of November. The election (because it is a see-saw) will probably exert increasing pressure on market sentiment. I feel that much of the market rise so far has been predicated on a Reagan victory. If Carter wins the election, Wall Street will not take kindly to the event.

INTEREST RATES: Is there a relationship between stocks and interest rates? Hamilton Bolton, the great bank credit pioneer, stated that the stock market can adjust to any level of interest rates, but it is the CHANGES in interest rates that really affects stock prices.

Charles Dow noted that the most important single consideration in appraising an investment was the return on your money. Since interest rates (for instance, the yield on T-bills) are one measure of the return on investment, and since ALL investments compete with each other on a value basis, the level and changes in prevailing interest rates are an important consideration in appraising the stock market.

BUT, can we come up with a significant correlation between stocks and interest rates. This is an area in which I have been doing research on for years. The closest relationship I have come up with is the relationship between the trend of stocks and the trend of the 6-month rate of change on the Standard & Poor's short-term Treasury Bond Index. Each week in S & P's "The Outlook" publication, the yield on the S & P Short Term Index is given. Once a month (end of the month) I divide the latest Short Term Treasury Bond yield by its yield of 6 months ago. The results of this study are shown on the page 4 chart.



The chart goes back monthly to 1967. There have been a few false signals, but in general the signals have been very good. The ratio heads down whenever interest rates are rising on a 6-month rate of change basis. When the index is at or near 1.30 it is reaching a climactic stage, and at such times stocks are usually falling. A buy signal for stocks is given whenever the ratio turns up from near or above the 1.30 area. You can study the signals on the chart (there have been 5 such buy signals since 1967).

A sell signal is given for stocks whenever the ratio rises to around 0.80, then turns decisively down. There have been five such signals since 1967, and you can study these on the chart. Only the 1975 sell signal proved ineffective, but even there we saw a sharp reaction in mid-1975.

The most recent action saw the ratio dive to an unprecedented 1.49 in March, 1980, then turn up. In so doing, it provided a perfect buy signal. From the 1.49 low, the ratio rose to a September peak of 0.76. This month the ratio dropped to .84, and the ratio for November is almost sure to fall below the 1.00 line, thereby providing a sell signal.

Conclusion: the rate-of-change study discussed above has now turned negative for stocks, and this will give us a further chance to gauge the strength of this remarkable market. The only action that would keep this ratio study bullish would be a sharp and concerted drop in interest rates between now and early November.

Further comments on interest rates: Almost everybody I read is forecasting "a decline in interest rates." I infer from this that (1) an awful lot of people WANT lower interest rates, and (2) a lot of people and institutions are loaded with bonds and would like a rally into which they can sell.

The Fed (under pressure from Carter and Treasury Secretary Miller) is under pressure to bring the rates down, and this might produce a little pre-election rally in bonds, and I don't expect much. The building deficits and inflation puts fundamental pressure on bond prices. Stay in T-bills or money market funds with the cash part of your reserves. By the way, the spectacle of G. William Miller playing politics with interest rates is little short of nauseating. The Treasury Secretary is the time-honored defender of US currency. How flagrant can one man be!

NOTES & QUOTES: I'm making just two trips between now and the end of this year. One is to the hospital to "watch" when my new daughter arrives. And the second is down to New Orleans to the *Seventh Annual Conference of the National Committee for Monetary Reform.* This is the King of all hard money conferences, put on by Jim Blanchard and his charming wife Jackie. There will be 45 speakers, 32 workshops, 200 exhibits and many special events. I mean the Blanchards really know how to put on a show, and the backdrop (New Orleans, which I call "Food City") is perfect for the event. The speaking list is truly a whopper including Paul Erdman, Nelson Bunker Hunt, Eliot Janeway, Ruff, Russell, Myers, Sinclair, Snyder, Pick and Deak. Also my friend, James Dines, and the man who has never worn a necktie–famed author, analyst, lecturer, and musicologist, Harry Browne. For information, write to NCMR, 8422 Oak St., New Orleans, LA., 70118.

I have never taken commissions or received discounts or part-payments for anything I have ever recommended in these reports. Therefore, when I say that I think you'll have a good time and an instructive time at New Orleans, I mean it and I gain nothing from it. When I speak at New Orleans I do receive a speaker's fee. Last year after receiving my fee from Jim, I walked over to his booth and put the money into Krugerrands. I was following John Exter's advice to "make it in paper, and save it in gold." I don't agree with Exter on that as a total policy, but the time seemed right last year, and I felt like owning a bit more gold. I still have those "Kruggies" and I'll probably leave them to my kids. And so it goes.

* *

It has been said that "Treason is a matter of timing." For instance, the Rosenberg executions of the 1950's would never take place today. And 10 years from now, the wholesale transmission of US technology to Russia (which is occurring today) might be considered treasonable.

I'm for Reagan, but it is mind-blowing to note the change in public morality. Consider this: between Reagan and his wife, Nancy's, immediate families there have been six divorces. All four of Reagan's children dropped out of college. The younger two children admit to having had out-of-wedlock, live-in relationships. Yet, to the credit of the news media and the nation, little is made of all this. In fact, so changed is the society that even Carter has said nothing of the Reagan family misfortunes (of course, Carter could also be open to family accusations, as well).

* *

Investors are increasingly reluctant to invest in long-term bonds. They're learning the hard way. Here's how they are learning: of all corporate bonds sold in 1980 thus far, only 14% are even showing a profit. Of the $27 billion in Baa bonds sold in 1980, only $4 billion are even or show a profit. That's all you have to know.

* *

Here's the wave of the future. If you can figure out what it means, you'll make millions. Today, 40 million workers are covered by 50,000 pension plans. These plans are collectively worth over $600 billion. The Labor Dept. projects that these pension plans will be worth $1.3 trillion by 1985, and an unbelievable $3 trillion by 1995. Within a few years, pension plans will OWN between 50% and 66% of all the shares on the NYSE!

* *

Our "progressive" tax system is now taking an ugly bite. The Tax Foundation notes that the top 10% in income group now pays 50% of all individual taxes in the US. And they wonder why there's a constant search on for new tax shelters!

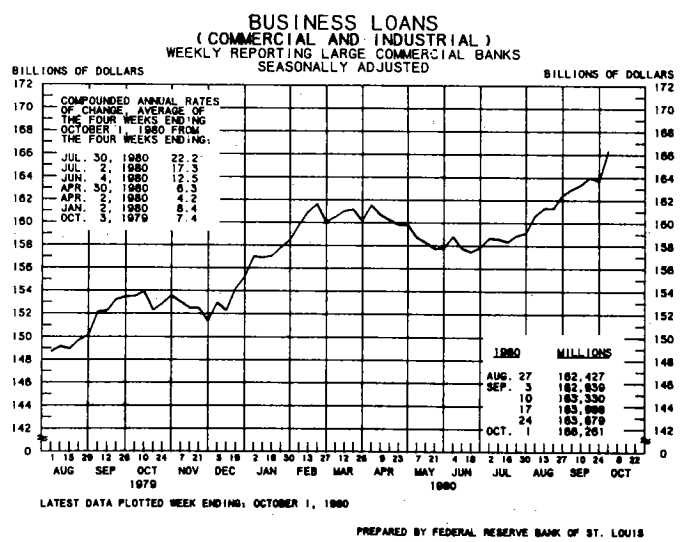
* *

Shocker of the Week: Literally 1 out of every 10 US Navy men has "split." So far in 1980, 7.4% of the Navy is absent without leave and 2.4% has deserted.

* *

I couldn't resist including this cartoon. It's from the London Economist, and it's a British View of the US election. The British have a way of putting things.....

Chart of the Week: Here's a chart showing business loans in the US taking off at a rate of 20% a year for the latest quarter. What's happening? Is business that good–or is business borrowing to finance bulging inventories and short-term expenses? Another figure which has me wondering (in view of booming business loans) is this one: the Mortgage Bankers Assoc. reports that in the second quarter mortgage delinquencies in the US hit a record high of 6.05%. In other words, more than one in every 20 residential mortgages is now delinquent!

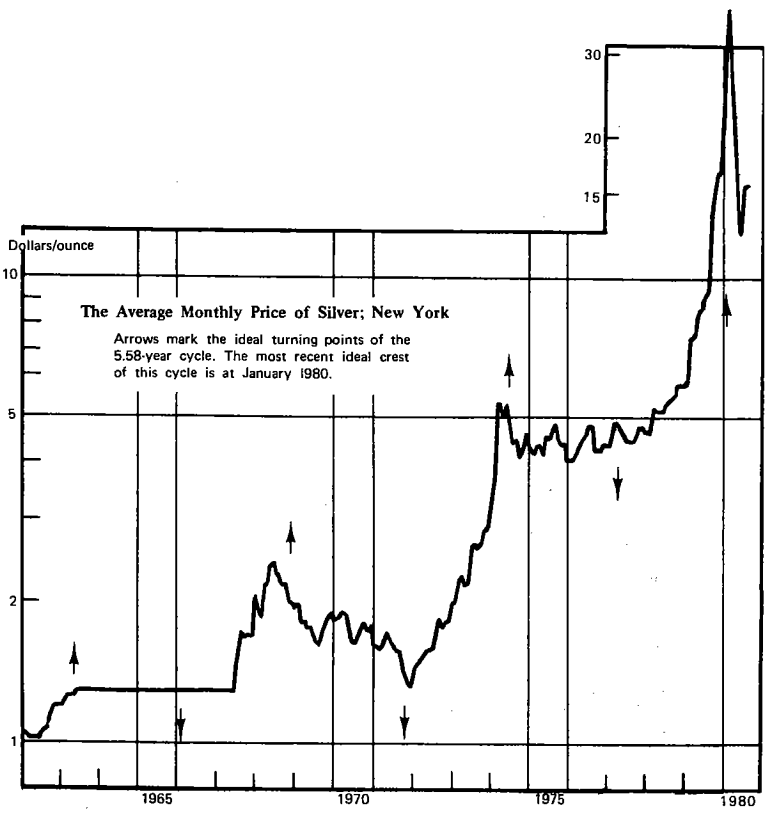

BUSINESS LOANS
(COMMERCIAL AND INDUSTRIAL)
WEEKLY REPORTING LARGE COMMERCIAL BANKS
SEASONALLY ADJUSTED
BILLIONS OF DOLLARS
BILLIONS OF DOLLARS
COMPOUNDED ANNUAL RATES OF CHANGE, AVERAGE OF THE FOUR WEEKS ENDING OCTOBER 1, 1980 FROM THE FOUR WEEKS ENDING:
JUL. 30, 1980 22.2
JUL. 2, 1980 17.3
JUN. 4, 1980 12.5
APR. 30, 1980 6.3
APR. 2, 1980 4.2
JAN. 2, 1980 8.4
OCT. 3, 1979 7.4
1980 MILLIONS
AUG. 27 162,427
SEP. 3 162,858
10 163,330
17 163,998
24 163,679
OCT. 1 166,261
AUG SEP OCT NOV DEC JAN FEB MAR APR MAY JUN JUL AUG SEP OCT
1979
1980
LATEST DATA PLOTTED WEEK ENDING: OCTOBER 1, 1980
PREPARED BY FEDERAL RESERVE BANK OF ST. LOUIS

GOLD, SILVER: Man lives a short span on this earth, maybe 60 to 80 years (with an occasional 90 or 100). And maybe that's why he's in a hurry to "do it," "make it," "have it," "solve it." But the markets are always there, and they'll be there as long as one man has something to sell to another.

Every investor loves a sure thing. Unfortunately, there are very few sure things in investing. Compound interest is sure, and that's why bankers and pension funds love it. But compound interest is also boring, and most investors would rather "go nuts in the market" than be guaranteed a doubling of their money in six years at 12%.

One of the fields of research which has fascinated many investors is that of cycles. If only we knew the exact cycles of sugar or beans we could "make a fortune." That's not exactly true, because although cycles exert a force on price, they do not indicate price. For instance, if the stock market cycle is down, but the market is in a very strong period, it may almost ignore the cycle and rally. Even so, the rally will probably not be as strong as it would have been if the cycle was bullish.

I am including here the cycle for silver, as shown in the current issue of Cycles magazine (a very fine magazine published at 124 S. Highland Ave., Pittsburgh, Pa., 15206 – the Steelers aren't the only good thing to come out of Pittsburgh). The chart shows the dominant cycle in silver which is the 5.58 year cycle. What this



means is that from bottom to bottom, each silver cycle consumes 5.58 years. Note how well silver's price followed the dominant cycle. The most dramatic call came in January, 1980 when the cycle topped out (up arrow). Silver broke from a high of $50 in January down to a low just above $10. One of the few people to note this cycle was my friend, commodity expert Walt Bressert, who called for a top in silver in January – right on the button.

The 5.58 year silver cycle has now turned down, and the next idealized major cycle bottom for silver should arrive around July-August, 1982.

It's hard to think of silver moving up or down without gold tending to at least move in the same direction. Does this mean that the metals will be dull or down until 1982? Not necessarily, but it does suggest that any bull move in the metals could be muffled or dampened by the dominant down-cycle. It means that all things being equal, the cyclic tendency of the metals will be lower until 1982 (but, of course, all things – particularly in today's environment – are not equal).

GOLD' NEAR TERM: The daily chart shows the first and second London gold fix from June to the present. As you can see (and as I suggested in the last Letter), some weakness has crept into the bullion picture. Two trendlines have been broken, and the September-October action has assumed the outline of a head-and-shoulders top. A breakdown of the pattern would occur on a London fix below 660.

Personally, I feel that the action is all part of a trading range which has developed since August. The trading range is bordered by 720 at the high and 605 at the low. My guess is that gold is fated to hold within this range for some time.

The 4X12 point and figure chart offers a different perspective. This is a chart based on only the PM London fix, and each box on the chart equals 4 points. On this chart, a fix of 660 or below would be bearish for bullion while a fix of first 680, then 712 would be necessary to turn bullion to the bull side.

The exponential moving averages (not shown) for gold are still bullish for gold. The 5-week MA is at 675, the 13-week MA is at 658 and the primary or 50-week MA is at a record high of 569. However, a decline by spot gold below 658 would send the 5-week MA heading down for a bearish crossing under the 13-week MA. Thus, for the near-term it would be a plus under this study

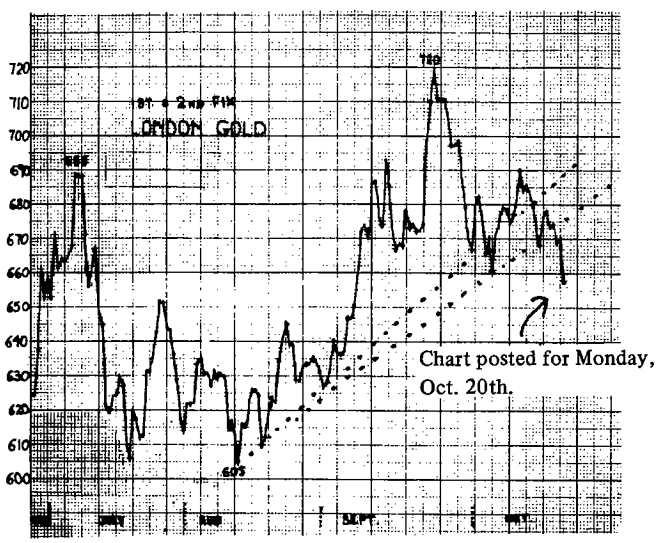
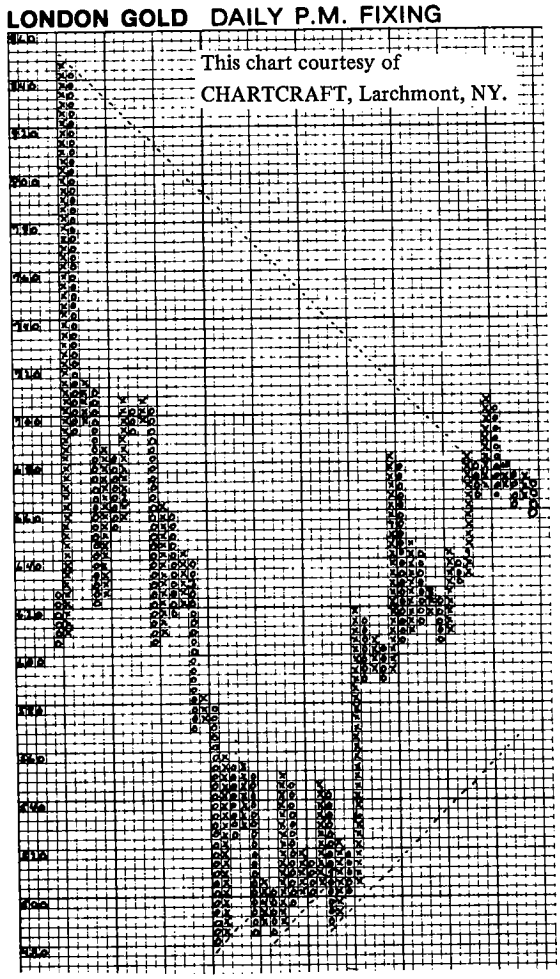


Chart posted for Monday, Oct. 20th.



if gold can hold generally above the 657-660 area. . . . The 13-week momentum (rate of change) for gold is down to 107 but still holding above 100. Gold would have to break below 630 to turn this study bearish.

Gold almost always makes an important low in the fourth quarter of each year (along with the gold shares), and we're probably heading for that now. Long term, I continue bullish on gold, but never hold so much (bullion or shares) that you can't sleep through a correction.

LATE MARKET NOTES: The market appears to be "trying" to correct, but so far the downside action is grudging. Transports are particularly loathe to give up any ground and this can provide us with a valuable hint. On any further weakness, watch the D-J Transportation Average closely. A continued resistance to decline on the part of Transports will act as a "rubber band," springing the market up on the rally days. Conversely, however, IF Transports do decide to weaken along with Industrials, we could see a correction get underway. The PTI, like the Transports, is giving little so far.

(Thought: despite Presidential scoldings, the banks have boosted the prime to 14% and the long-promised "lower interest rates" continue to elude Wall Street and the nation . . . meanwhile, the money supply runs wild).

NEXT MAILING: November 5th